No. 9234 8

In the United States Circuit Court of Appeals for the Ninth Circuit

J. E. Riley Investment Company, petitioner

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

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CITATIONS

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OPINION BELOW

The only previous opinion in this case is the memorandum opinion of the Board of Tax Appeals (R. 19–28), which is unreported.

JURISDICTION

This appeal involves a deficiency in income and excess-profits taxes for the year 1934 in the amount of $618.41, and is taken from a decision of the Board of Tax Appeals entered May 11, 1939. (R. 29.) The case is brought to this Court by petition for review filed June 15, 1939 (R. 29–36), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

The taxpayer, in filing its income-tax return for the year 1934, filed no statement of election with respect to percentage depletion. The question presented is whether after having failed to file a statement of election, it is entitled to percentage depletion for that year.

STATUTE AND OTHER AUTHORITIES INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 1. APPLICATION OF TITLE.
>
> The provisions of this title shall apply only to taxable years beginning after December 31, 1933. * * * (U. S. C., Title 26, Sec. 1.)
>
> SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.
>
> *   *   *   *   *
>
> (b) *Basis for Depletion.*—
>
> *   *   *   *   *
>
> (4) *Percentage depletion for coal and metal mines and sulphur.*—The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per

centum of the net income of the taxpayer (computed without allowance for depletion) from the property. A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. The method, determined as above, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer, or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer, either directly or through one or more substituted bases, as defined in that section. (U. S. C. Title 26, Sec. 114.)

H. Rep. No. 704, 73d Cong., 2d Sess., p. 29:

Section 114 (b) (4). Percentage depletion for coal and metal mines and sulphur: Under the Revenue Act of 1932, percentage depletion was first allowed in the case of coal, metal, and sulphur mines. That act required the taxpayer to make in his 1933 return an election, binding for 1934 and subsequent years, as to whether the depletion deduction in such cases was to be computed upon a percentage basis. To avoid administrative complexity, your committee is of the opinion that the taxpayer making his first return under the bill should be entitled to a new election as to whether he will compute his allowance for depletion in the case of coal, metal, and sulphur mines upon the percentage basis. This section of the bill so provides.

S. Rep. No. 558, 73d Cong., 2d Sess., p. 36:

Section 114 (b) (4). *Percentage depletion for coal, metal mines, and sulphur.*

Under the Revenue Act of 1932, percentage depletion was first allowed in the case of coal, metal, and sulphur mines. That act required the taxpayer to make in his 1933 return an election, binding for 1934 and subsequent years, as to whether the depletion deduction in such cases was to be computed upon a percentage basis. In order to avoid administrative complexities the House bill permitted the taxpayer a new election in making his first return under the proposed bill. The committee approves the House bill, but has inserted an amendment to the subsection so as to make the election made for 1934 binding not only upon the taxpayer, but upon any other person who subsequently acquires the property if the basis of the property (for determining gain) in his hands is under section 113 determined by reference to the basis in the hands of the person exercising the option.

STATEMENT

The facts as found by the Board of Tax Appeals may be summarized as follows (R. 19–22):

The taxpayer is a Nevada corporation with its principal office and place of business at Flat, Alaska. Its business is the mining of gold. (R. 19.)

Flat is located in a remote part of Alaska on the 62nd parallel of latitude and the 158th meridian of longitude. During the season of navigation, the usual means of travel to Flat from Seward, the seaport, is from Seward, by railroad, to Nenana on the Yukon River, a distance of 415 miles, then by water via the Yukon River to Holy Cross, a distance of over 700 miles, and thence via a tributary of the Yukon to Flat, a distance of 420 miles. When navigation is not open, travel to and from Flat is either by plane or on foot. It requires about two weeks to go over the 400-mile trail on foot from Flat to Anchorage, which is the nearest town. (R. 19–20.)

The uncertainty and slowness of the winter mail service invariably resulted in current tax return forms reaching Flat too late for timely execution and filing. In order to avoid delinquency, it was the custom of taxpayer's officers to use old return forms; consequently taxpayer's original return for

1934 was filed on a 1933 form which had been mailed to taxpayer by the Collector of Internal Revenue at Tacoma, Washington. In the winter of 1934, mail came to Flat part way by plane and part way by dog team. In order to be sure of filing the 1934 return on time, an officer of taxpayer executed it on January 2, 1935, using the 1933 form, as stated. It reached Tacoma on January 29, but mail from Flat sometimes took two months in arriving at Tacoma. (R. 20.)

When taxpayer's first 1934 return was filled out, its officers did not know of the statutory provisions allowing percentage depletion, but did know that unless the law had been changed, taxpayer was not entitled to depletion, as it had no basis for cost depletion. The Collector in sending the forms, had not advised the taxpayer with respect to statutory depletion, and all the knowledge then available to it on this score was contained in Instruction No. 23 attached to the 1933 form, which reads as follows (R. 21):

> 23. *Depletion.*—If a deduction is claimed on account of depletion, secure from the collector Form D (minerals), Form E (coal), Form F (miscellaneous non-metals), Form O (oil and gas), or Form T (timber), fill in and file with return. If complete valuation data have been filed with Questionnaire in previous years, then file with this return information necessary to bring your depletion schedule up to date, setting forth in full

statement of all transactions bearing on deductions or additions to value of physical assets with explanation of how depletion deduction for the taxable year has been determined. See Sections 23 (1) and 114 of the Revenue Act of 1932.

Taxpayer's officer read the instructions before executing the return for 1934. (R. 21.)

Taxpayer's officers first actually learned of the statutory depletion provisions in August, 1935, when a revenue agent visited Flat and advised that taxpayer was entitled to percentage depletion for both 1933 and 1934. This agent prepared reports to that effect, as a result of which a refund was paid for 1933, but not for 1934; as to the latter year, the Commissioner ruled that taxpayer had failed to claim percentage depletion in its original return and hence was not entitled to claim it subsequently. (R. 21–22.)

If taxpayer's officers had known of the 1934 statutory provisions, they would have elected to take percentage depletion. (R. 22.)

As soon as taxpayer's officers were advised that percentage depletion had been disallowed, they filed both an amended return claiming such depletion in the amount of $13,600.57, and a claim for refund. (R. 22.)

Taxpayer's gross receipts from gold mining for the year 1934 were $99,711.56, and it has paid a tax for that year in the amount of $4,684. (R. 22.)

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The Commissioner of Internal Revenue determined that the taxpayer was not entitled to percentage depletion for the year 1934 and his action was affirmed by the Board of Tax Appeals. (R. 19–28.)

SUMMARY OF ARGUMENT

1. The taxpayer is claiming a deduction from gross income and we therefore deem it appropriate to point out that a taxpayer is not entitled as a matter of right to take any deductions from gross income. Only such deductions as may be brought within the four corners of the statute are permitted. The statute under which the taxpayer is claiming the deduction is Section 114 (b) (4) of the Revenue Act of 1934, which provides that a taxpayer making its first return under the Act shall state whether it elects to have its depletion allowance computed with or without regard to percentage depletion. The section further provides that if no such statement is made in the return, then the allowance shall be computed without regard to percentage depletion. The taxpayer made no statement of election in its first return under the Act. Accordingly, it is not entitled to percentage depletion.

2. The words "first return", as used in the stateute, have reference to the first return filed after the passage of the Act, and the election made in that return may not later be repudiated by the filing of an amended return. The courts have repeatedly held that the filing of a return on one basis pre-

cludes the filing of amended returns on another basis. Since the statute is mandatory it leaves no discretion in the Commissioner to accept amended returns.

ARGUMENT

I

The taxpayer is not entitled to percentage depletion for the year 1934

The taxpayer in the case at bar is claiming a deduction from gross income. We therefore deem it appropriate to point out that a taxpayer is not entitled as a matter of right to take any deductions from gross income and that only such deductions as may be brought squarely within the four corners of the statute are permitted. *New Colonial Co.* v. *Helvering,* 292 U. S. 435; *Burnet* v. *Thompson Oil & G. Co.,* 283 U. S. 301; *Lindley* v. *Commissioner,* 63 F. (2d) 807 (C. C. A. 2d). Furthermore, Congress may condition, limit or deny deductions from gross income in any manner it sees fit. *Helvering* v. *Ind. Life Ins. Co.,* 292 U. S. 371.

The statute under which the taxpayer is claiming the deduction in the present case is Section 114 (b) (4) of the Revenue Act of 1934, c. 277, 48 Stat. 680. That section provides in part as follows:

> * * * *A taxpayer making his first return under this title* in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to per-

> centage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. *If the taxpayer fails to make such statement in the return,* the depletion allowance for such property for such year shall be computed without reference to percentage depletion. *The method, determined as above,* of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer * * *. [Italics supplied.]

Section 1 of the Revenue Act of 1934 provides that the provisions of Title I (income tax) shall be applicable only to taxable years beginning after December 31, 1933. The taxpayer kept its books and filed its income-tax returns upon the basis of a calendar year, so that the first return filed by it under the Revenue Act of 1934 was the return for the calendar year 1934. Thus, under the provisions of Section 114 (b) (4), the taxpayer, in order to secure the benefit of percentage depletion, was required to state in its return for that year its election to have its depletion computed with regard to percentage depletion. The section further provides that if the taxpayer fails to make such a statement in its return, then the depletion allowance shall be computed without regard to percentage depletion. Admittedly, the taxpayer filed no such statement with its 1934 return. Accordingly, under the clear and unambiguous terms of the statute, it is not entitled to percentage depletion.

The Government's position is fortified by the language and structure of Section 114 (b) (4). The section first provides that a taxpayer shall state in its first return filed under the act whether it elects to have its depletion allowance computed with or without regard to percentage depletion. On the facts in the present case, that language alone would be sufficient to preclude the allowance of percentage depletion to this taxpayer. But the section does not stop there. It then goes on to say that if no such affirmative action is taken, then the depletion allowance shall be computed without reference to percentage depletion. In other words, Congress said there are two methods of computing depletion and you may choose whichever one you please. However, if you fail to file a statement with your first return indicating your choice, then under no consideration are you entitled to percentage depletion.

It will be noted that the section provides that the taxpayer *shall* state whether he elects, *et cetera,* and that if he fails to make such a statement the depletion allowance *shall* be computed without reference to percentage depletion. The use of the word "shall" indicates that Congress was not only granting an election which was to be exercised when the first return was filed, but was making it mandatory that an election be made.

Taxpayer contends that Congress, in enacting Section 114 (b) (4), intended to broaden and liberalize the depletion allowance and that to construe the statute as the Board has done deprives the taxpayer of a deduction. It argues, in effect, from this, that the clear language of the statute should be ignored and a depletion allowance granted, based upon the equities of the case. It fails to appreciate that neither the Commissioner nor the Board is vested with any discretion in the matter of deductions and that only those deductions which are clearly within the statute are permitted.

Furthermore, Section 114 (b) (4) deprives this taxpayer of a deduction for depletion only in the event it has no capital to be recovered through such allowances, since a taxpayer is always entitled to depletion based upon cost. It is only when a taxpayer's capital has been restored to him that he is denied a deduction for depletion; and in such a case there is no sound reason, equitable or otherwise, why a further allowance should be granted.

There is no contention here that the taxpayer in its original return for the year 1934 elected to have depletion computed with reference to percentage depletion. Admittedly it filed no such statement. The filing of a return without such a statement constituted a binding election, and under the plain words of the statute that election may not later be repudiated.

II

The original return of the taxpayer for the year 1934 was the "first return" within the meaning of Section 114 (b) (4) and the election made by the filing of that return may not be revoked by the filing of an amended return

On January 29, 1935, the taxpayer filed its income-tax return for the year 1934, and, as shown above, the return contained no statement of election. Sometime after August, 1935, it filed an amended return and a claim for refund in which percentage depletion was claimed. Taxpayer contends that the amended return related back and became a part of the original return and that the words "first return" in Section 114 (b) (4) should be construed to mean the return for the year 1934, together with all amendments thereto. But that contention ignores the plain words of the statute. The language of the statute is: "A taxpayer making his first return under this title * * *". The language plainly means that the election is exercised by the filing of the *first return for the first year*. There is nothing in the statute which indicates that the election once made may later be revoked simply by the filing of an amended return. Obviously, Congress intended that the filing of the original return should settle the matter for all time; otherwise there would have been no purpose in writing into the statute the sentence prescribing the result of failure on the part of the taxpayer to make an affirmative statement as to depletion.

If taxpayer's argument were carried to its logical conclusion, it would mean that a taxpayer could revoke his election at any time simply by the filing of an amended return, and, since there is no legal limit to the number of amended returns that may be filed, a taxpayer could go back and change from one method to the other whenever the mood struck him.

The courts have repeatedly held that a taxpayer who has an election under the taxing statutes exercises that election by the filing of the original return, and that such election may not later be repudiated by the filing of an amended return. The latest decision upon the subject, perhaps, is *Pacific National Co.* v. *Welch,* 304 U. S. 191. There a taxpayer, in filing its original return, elected to report its profits from realty sales upon the completed transaction basis. Later it filed an amended return claiming that the profits should have been returned upon the installment basis. In holding that it was bound by the election it exercised in filing the original return, the Court said (pp. 194–195):

> The amount of the tax for the year in question is only one of many considerations that may be taken into account by the taxpayer when deciding which method to employ. The one that will produce a higher tax may be preferable because of probable effect on amount of taxes in later years. In case of overstatement and overpayment, the taxpayer may obtain refund calculated accord-

ing to the method on which the return was made. Change from one method to the other, as petitioner seeks, would require re-computation and readjustment of tax liability for subsequent years and impose burdensome uncertainties upon the administration of the revenue laws. It would operate to enlarge the statutory period for filing returns, section 53 (a), 26 U. S. C. A. sec. 53 (a) and note, to include the period allowed for recovering overpayments, section 322 (b), 26 U. S. C. A. sec. 322 note. *There is nothing to suggest that Congress intended to permit a taxpayer, after expiration of the time within which return is to be made, to have his tax liability computed and settled according to the other method. By reporting income from the sales in question according to the deferred payment method, petitioner made an election that is binding upon it and the commissioner.* [Italics supplied.]

The present case is even stronger for the Commissioner. In the above case the statute merely provided that in the case of sales of realty where the initial payments do not exceed 40 percent of the selling price "the income may" be reported on the installment basis. In the present case the statute not only grants an election, but provides that if it is not exercised in the manner outlined therein the taxpayer shall be deemed to have rejected percentage depletion.

In *Rose* v. *Grant,* 39 F. (2d) 340 (C. C. A. 5th), a husband and wife filed, on March 15, 1922, a joint return for the year 1921. On December 15, 1922, they filed or attempted to file separate returns. In holding that they were bound by the election exercised in filing the joint return, the court said (p. 341):

> The husband and wife having made a single joint return within the time prescribed by law, the Commisisoner was fully justified in declining to accept the separate returns made contrary to the ruling above quoted and long after the time prescribed by the statute.
>
> The statute gives the right to the husband and wife to file either a separate or a joint return, but not to change from one to the other at any time it appears to their advantage to do so. The impossibility under such a system of determining the amount of the tax due as required by section 250 (b) of the Revenue Act of 1921 (42 Stat. 264), as well as the administrative inconvenience thereof, condemns it.

See also *Buttolph* v. *Commissioner,* 29 F. (2d) 695 (C. C. A. 7th); *Champlin* v. *Commissioner,* 78 F. (2d) 905, 911 (C. C. A. 10th).

Similarly, where affiliated corporations were given an election with respect to the filing of separate or consolidated returns, the courts have held that the filing of a return on one basis or the other constituted a binding election which could not later be repudiated. *Alameda Inv. Co.* v. *McLaughlin,* 33 F. (2d) 120 (C. C. A. 9th); *Radiant Glass Co.* v. *Burnet,* 54 F. (2d) 718 (App. D. C.); *Lucas* v. *St. Louis National Baseball Club,* 42 F. (2d) 984 (C. C. A. 8th). In the *Alameda Inv. Co.* case, this Court said (pp. 120–121):

> The separate and consolidated returns differ widely in form with different results to both the taxpayers and the government and it would seem obvious that, when the taxpayers have once made their election, filed their returns, separate or consolidated, and paid their taxes, the election is binding on all parties concerned.

Our contention that the election is made by the filing of the original return and that the election made in that return may not later be rescinded by the filing of an amended return is also supported by the recent capital stock tax cases. In those cases the tax is levied upon the declared value of the stock as "declared by the corporation in its *first return* under this section". With but two exceptions, all the decided cases have held that a taxpayer is bound by the value shown in the first return filed under the act, and that such value may not be increased or decreased by the filing of an amended return. See *Haggar Co.* v. *Commissioner,* 104 F. (2d) 24 (C. C. A. 5th); *Blake & Kendall Co.* v. *Commissioner,* 104 F. (2d) 679 (C. C. A. 1st); *William B. Scaife & Sons Co.* v. *Driscoll,* 94 F. (2d) 664 (C. C. A. 3d); *Shire* v.

McGowan (W. D. N. Y.), decided May 25, 1939, not yet reported but found in 1939 C. C. H., Vol. 4, p. 10,295; *Rosoff Tunnel Corp.* v. *Higgins* (S. D. N. Y.), decided December 7, 1938, not yet reported but found in 1939 C. C. H., Vol. 4, p. 9428; *William A. Webster Co.* v. *Commissioner,* 37 B. T. A. 800; *A. J. Crowhurst & Sons, Inc.* v. *Commissioner,* 38 B. T. A. 1072.

In holding that the original return was the "first return" within the meaning of the statute, the court in the *Haggar Co.* case said (p. 27):

> To make the plan work, it is necessary to confine the determination of tax liability to one return, and only one. The selection of the first, an intermediate, or the last return is a matter within the legislative discretion. In the act under consideration, the first return was selected.
>
> The Board of Tax Appeals having held that the declaration contained in the first return was the true basis for the computation of the tax, and that the deficiency assessed by respondent was correct, its decision is affirmed.

To the same effect is the language of the court in the *Scaife & Sons* case (p. 666):

> The statute declares that the declaration of value contained in the first return cannot be amended. This language is plain, and it means what it says. Therefore the collector possessed no power to accept and file the amended return in lieu of the original return.

The only cases to the contrary are *Glenn* v. *Oertel Co.,* 97 F. (2d) 495 (C. C. A. 6th), and *Philadelphia Brewing Co.* v. *United States,* 27 F. Supp. 583 (C. Cls.). We believe that those decisions are plainly erroneous. However, they are distinguishable from the instant case on the ground that the amended returns in those cases were filed within the time as extended by the Commissioner for filing the original returns. In the present case the original return was due on or before March 15, 1935, and the amended return was not filed until some time after August, 1935.

Raymond v. *Commissioner,* 34 B. T. A. 1171, and *Lucas* v. *Sterling Oil & Gas Co.,* 62 F. (2d) 951 (C. C. A. 6th), cited by the taxpayer, are distinguishable upon the ground that in those cases neither the statute nor the regulations prescribed the time when the election should be made. In the instant case the statute specifically provides that the election must be made in the first return and then goes on to say how the depletion shall be computed in the event no such affirmative election is made. The statute being mandatory leaves no room for the argument that an election once made may be rescinded by the simple act of filing an amended return.

The taxpayer relies principally upon *C. H. Mead Coal Co.* v. *Commissioner* (C. C. A. 4th), decided August 28, 1939, not yet reported but found in 1939 C. C. H., Vol. 4, p. 10,661. There the court held that the words "first return" as used in Section

114 (b) (4) included a properly amended first return and that Congress did not intend to limit a taxpayer's right of election to the first form filed. With all due respect to the Fourth Circuit, we believe that the decision is erroneous, because it reads into the statute something which is not there and attempts to construe language which is clear and unambiguous, and therefore needs no construction.

Taxpayer argues that it should not be held to its election because at the time of filing its return, it was ignorant of the requirements of the statute. We know of no rule of law, and taxpayer has referred us to none, which would permit a taxpayer to circumvent the mandatory requirements of a statute simply because it was ignorant of its rights thereunder. It is true that a strict application of the law in the present case deprives the taxpayer of a deduction. However, the remedy lies, not with the courts, but with Congress, which has power to change the act, if it is so inclined.

CONCLUSION

It follows that the decision of the Board of Tax Appeals is right, is in accordance with law, and should be affirmed.

Respectfully submitted.

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